



Are Startups Eligible for the SBA's New Paycheck Protection Program (PPP) Loans?

March 31, 2020

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136), among other provisions, created the Paycheck Protection Program (PPP). Under the PPP, a lender may provide "covered loans" to assist *small businesses* (defined as either businesses that have 500 or fewer employees or that meet the general size standards under the Small Business Act), small 501(c)(3) nonprofit organizations, and small 501(c)(19) veterans organizations that have been adversely affected by COVID-19. These covered loans—also known as PPP loans—have

- a 100% SBA loan guarantee;
- a maximum term of 10 years;
- no associated fees; and
- an interest rate not to exceed 4%.

PPP loan proceeds can be applied to specific purposes, such as payroll (including compensation to employees and owners), leave payments, state and local taxes assessed on compensation paid by the business, mortgage or rent, utilities, and interest on any other debt obligations paid during the covered period. The covered period runs from February 15, 2020, through June 30, 2020.

The SBA's Affiliation Rules

Despite directly employing 500 or fewer employees, some startups (and other small businesses) might be ineligible for PPP loans because of the SBA's "affiliation rules." The affiliation rules are designed to prevent "big" businesses from accessing SBA's programs that are statutorily required to benefit only independently owned and controlled "small business concerns." For example, a business of 1,000 employees could break up into five businesses with 200 employees each—all owned by the same parent company—in order to fall under the 500 employee threshold.

Under the SBA's affiliation regulations, an investor could be deemed to have "control" of multiple businesses, thereby making all of the affiliated businesses under that investor's control ineligible for SBA assistance if they, in the aggregate, are too "big" to be eligible. Control can be determined in a number of ways, such as a single investor owning 50% or more of the value of the business's stock or its voting

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IN11298

rights for its board of directors (who review important business decisions made by management). Control can also be determined in some less than obvious ways, including by having multiple investors with minority ownership, family links between multiple entities, and certain contractual relationships or "economic dependency." The affiliation rules also apply to both for-profit business and nonprofit relationships. As such, the SBA's affiliation rules could be particularly important for lenders that issue PPP loans and the businesses that seek them.

In particular, affiliation rules could prevent certain startups and other businesses that have received investments from private investment funds and investors (e.g., private equity funds, venture capital funds, and "angel investors") from being eligible for PPP loans. Private equity funds tend to invest in a broad array of businesses (including smaller businesses and larger, more established businesses). Venture capital funds and angel investors often target their investments to startups and more early stage companies. These private investment funds and investors often seek to control the company's business decisions by purchasing a majority of the business's stock, thereby giving them control over management decisions. Alternatively, these funds and investors may condition their investments on receiving a special class of the business's stock that gives them disproportionate voting shares, relative to their share of ownership of the total value of stock issued ("high vote shares"). Both strategies are intended to protect the rate of return on investment. These arrangements, though, could lead a fund or an investor to having "control" over multiple businesses. In the aggregate, if all affiliated businesses employ more than 500 employees, then potentially all of the businesses under the affiliation network are ineligible for PPP loans.

PPP Exceptions to the Affiliation Rules

The CARES Act waives the affiliation rules in three specific instances:

- 1. businesses owned by franchises identified by the SBA,
- 2. businesses that receive financial assistance from licensed Small Business Investment Companies (SBICs), and
- 3. businesses operating in the accommodation and food services industry (North American Industry Classification System (NAICS) Code 72) that have no more than 500 employees per physical location. For example, if a single investor wholly owns a set of five hotels, organized as separate businesses, that each employ 200 people, then the affiliation rules are waived; the investor could receive PPP loans for each of the five hotel businesses.

For more information on SBA loan programs and the SBA-related provisions of the CARES Act, see CRS Report R46284, *COVID-19 Stimulus Assistance to Small Businesses: Issues and Policy Options*, by Robert Jay Dilger, Bruce R. Lindsay, and Sean Lowry.

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